



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

Release Number: **201702043**
Release Date: 1/13/2017
UIL Code: 501.07-00

Date: October 19, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Dear :

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(7) of the Internal Revenue Code (the Code). Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

Sincerely,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

Enclosures:

Notice 437

Redacted Letter 4034, *Proposed Adverse Determination under IRC Section 501(a) Other Than 501(c)(3)*

Redacted Letter 4040, *Final Adverse Determination under IRC Section 501(a) Other Than 501(c)(3) - No Protest*



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

Date: August 22, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

B = Date

C = State

D = Arts Association

F = Art Gallery

x = hours

y dollars =

z dollars =

UIL:

501.07-00

Dear :

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code. Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(7) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

Issue

Do you qualify for exemption under section 501(c)(7) of the Code? No, for the reasons stated below.

Facts

You were formed under the provisions of State C's Limited Liability Company Act as a limited liability company (LLC) on date B. You submitted bylaws with your Articles of Organization as an LLC. Article II of your bylaws states your mission "... shall be to promote artists."

Article III, Section 1 of your bylaws indicates you have one class of membership and that: "Membership is open to any practicing artist upon application to the organization and payment of annual dues."

You state that you have a lease agreement with arts association D for the use of art gallery F. The lease agreement states that F may only be used by groups engaged in promoting the arts. It further states that you, as tenant, will carry on and conduct business under the name of F and will not change such name without prior written consent. The term of the lease is for one year and may be extended by agreement of both parties. Rent is for \$125 annually and is payable at the time of signing. Should D decide to sell F, you have the right of first refusal assuming you are not in default of the lease.

You state that your members each have an allotted space in which to display their original artwork to sell. You currently have eight members who volunteer to work at F. Working members volunteer x hours and pay y dollars plus a 10% commission to F. Your participating artist agreement states that all items displayed for sale will be original art as defined by your guidelines. Each participating artist will have a maximum of 48 square feet. Each artist will share equally in the staffing of F during the season. If an artist does not work during scheduled times, the artist will be charged a rate of z dollars per hour missed, deducted from the artist's proceeds. More than one infraction will result in the artist being asked to remove their items from F.

The artist will be paid on a monthly basis and the artist is responsible for keeping their allotted space filled throughout the season. All artwork will be recorded on the provided inventory form with a consecutive number beginning with assigned code letter for that artist. A description for each item and the price for each item will be included on the form. Each item will be tagged to correspond with the number and price listed on the inventory form.

You further state that you have a jury process to determine eligibility to sell at F. The jury consists of the officers of your organization. You state you strive to have a variety of artwork for sale to enhance sales; however, because of limited space available, you have a waiting list of artists who would like to participate in selling their artwork. You strive to have no more than two persons selling the same type of artwork at the same time.

F also has five consignment members who will pay y dollars plus a 33% commission to F. You use the profits of F to pay the expenses of doing business plus maintenance. The consignment artist agreement states that all items displayed for sale will be original art as defined by your guidelines. Each participating artist will have a maximum of 24 square feet. Consignment items are to be different from items sold at F by participating members. Your Executive Committee will jury the artwork for sale before consignment artists are accepted for F.

You state that prices of artwork are determined by the artist who created the artwork and the price is displayed on the artwork.

In addition, you indicate that social activities conducted are strictly on a volunteer basis and are very informal and you further state you conduct two social events each year.

Revenue for the income represents membership dues, commissions paid by members and commissions paid by nonmembers. The majority of the income comes from the sale of artwork by members. The expenses paid are to operate F.

When asked to provide a breakdown of revenues that were stated in the application, the figures you submitted were substantially different than the revenues listed in the application.

Law

Section 501(c)(7) of the Code provides for the exemption from Federal income tax of clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Treas. Reg. § 1.501(c)(7)-1(a) states that the exemption provided by section 501(a) of the Code for an organization described in section 501(c)(7) of the Code applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its net earnings inure to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

Treas. Reg. § 1.501(c)(7)-1(b) states that a club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber, or other products, is not organized and operated exclusively for pleasure, recreation and other nonprofitable purposes, and is not exempt under section 501(a) of the Code. Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption. As previously noted, section 501(c)(7) of the Code requires that substantially all of a social club's activities be social or recreational activities for members.

Public Law 94-568, 90 Stat. 2697, provides that a social club may receive up to 35 percent of its gross receipts, including investment income from sources outside its membership without losing exemption. Within this 35 percent amount, not more than 15 percent of the gross receipts should be derived from the use of a social club's facilities or services by the general public. This means that an exempt social club may receive up to 35 percent of its gross receipts from a combination of investment income and receipts from nonmembers so long as the latter do not represent more than 15 percent of the total receipts.

Revenue Ruling 55-716, 1955-2 C.B. 263 (as modified by Rev. Rul. 83-170, 1983-2 C.B. 97) held that an organization formed for the purpose of furnishing television antenna service to its members is not entitled to exemption from federal income tax under section 501(c)(7) of the Code. The ruling states: "The term 'club' as used in (section 501(c)(7)) contemplates the commingling of members, one with the other, in fellowship. Personal contacts and fellowship must also play a material part in the life of an organization in order for it to come within the meaning of the term 'club.'"

In Rev. Rul. 69-527, 1969 2 C.B. 125, a social club formed to assist its members in their business endeavors through study and discussion of problems and other activities at weekly luncheon meetings did not qualify for exemption under section 501(c)(7) of the Code because it was organized and operated primarily to aid its members in its individual business endeavors.

Application of law

You are not described in section 501(c)(7) for the Code because you are neither organized nor operated for pleasure, recreation, or other nonprofitable purposes.

Section 501(c)(7) of the Code and the associated Treasury Regulations indicate that a social club must be formed for the pleasure, recreation and social purposes of its members. In addition, Public Law 94-568 states that no more than 15% of a social clubs gross receipts should be derived from non-member sources. Although it appears a majority of your income is from commissions paid by members, the legislative history of Public

Law 94-568 indicates that, while Congress intended to increase the allowance of nonmember income from club facilities, it was not meant to eliminate the prohibition against engaging in nontraditional businesses. Promoting your artist members by conducting art sales indicates you are engaging in a nontraditional business.

You do not meet the requirements of Treas. Reg. § 1.501(c)(7)-1(a) because you are not organized and operated for pleasure, recreation and other nonprofitable purposes.

You do not meet the requirements of Treas. Reg. § 1.501(c)(7)-1(b) because your primary purpose is engaging in the business of selling the artwork of your members.

You are similar to the organization described in Rev. Rul. 55-716 in that you lack a commingling aspect within your membership as well as a lack of fellowship since your social activities are “very informal” and you conduct only two social events each year. As stated in this ruling, personal contacts and fellowship must play a material part in the organization in order to be considered a club.

Similarly, you are like the organization described in Rev. Rul. 69-527. The organization in the ruling was found to be organized and operated primarily to aid its members in its individual business endeavors. Likewise, you were formed to promote your member artists in selling their works of art.

You have not established that your activities include evidence of personal contact, commingling and fellowship among members. Members are not bound together by a common objective directed toward pleasure, recreation and other nonprofitable purposes. Therefore, you are not described in section 501(c)(7) of the Code.

Conclusion

Based upon the information submitted, you do not qualify for exemption under section 501(c)(7). You are not formed for social and recreational purposes but rather are formed to promote the interests of your members.

If you don't agree

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send a statement to us within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative
- One of the following declarations:

For an officer, director, trustee, or other official who is authorized to sign for the organization:

Under penalties of perjury, I declare that I examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

For authorized representatives:

Under penalties of perjury, I declare that I prepared this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

We'll review your protest statement and decide if you provided a basis for us to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*.

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court at a later date because the law requires that you use the IRS administrative process first (Section 7428(b)(2) of the Code).

Where to send your protest

Please send your protest statement, Form 2848, if needed, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

If you agree

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

You can find all forms and publications mentioned in this letter on our website at www.irs.gov/formspubs. If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

Enclosure:
Publication 892